



BUYING OR SELLING A BUSINESS: “Why Do I Need All That Paper?”

by Robert A. Singer

A common concern of those who are buying or selling a private business are the costs of “all that paper” generated by the attorneys. “For goodness sakes, I am not buying Exxon.” “I just want to sell my company, not send the lawyers’ children through college.” These and similar comments are often made only partially (and sometimes not) in jest.

It is expensive to buy or sell a company. Lawyers’ fees do mount up. Some in our profession respond to clients’ concerns with a glib “well, it is just a cost of doing business.” That is an answer, but not one that explains why all that paper is necessary or enables a client to make a business decision about how much he or she should spend for legal advice.

Lawyers should not provide services and bill for them in a vacuum. Frank and honest advice about what is necessary, what more would be useful, and what would be optimal is for the lawyer to provide. The decision about the level of “lawyering” is for the client.

Every acquisition/sale transaction requires a basic level of agreement. Statutes, rules, common law and common sense mandate that certain provisions be present. Whether the transaction is a merger or a stock or asset purchase or sale, the law requires that the mechanisms for effecting the transfer of ownership and the exchange of consideration be established. There are representations and warranties that are necessary for clarifying what is and is not being acquired (e.g. I own this and no one else has any ownership interests in it). There are conditions to each party’s obligations to close the transaction that must be stated (e.g. I do not have to buy your assets until the lessors of your plant, warehouse, etc. consent to your assignments of leases to me). The reasons for and the parameters of these basic agreements are generally well-

understood and the legal costs of “papering them” seldom cause client concern.

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Legal counsel experienced in business transactions generally advise that much beyond the basics should be included in the transaction documents. We often, however, do not explain the factors that our client should consider in deciding how much is too much or, conversely, too little.

The “beyond the basics” portions of transaction documents can be evaluated by buyers and sellers of businesses using two frames of reference. What degree of “insurance” do you desire is the first. From a buyer’s perspective, the broader the scope of your due diligence rights and the greater the detail concerning what you are buying, how that critical mass of assets has been operated, what customer relationships exist and have existed, what claims there are or could be, the nature of vendor and employee relationships, etc., the more comfort you can have that your purchase price will not, in effect, be increased through having to address at some point in the future problems arising from the past. Similarly, covenants about interim operations from the time of signing until the closing have the effect of preserving the value of what is to be acquired. Conversely, detailed disclosures of what is being conveyed and representations, warranties and covenants that have

“materiality” limitations and that can be “scheduled” (i.e. exceptions disclosed which a buyer must “close over”) allow a seller to limit future buyer claims that what was promised was not delivered. Put simply, buyers and sellers should evaluate how much they want to spend on insuring that what they bargained for is exchanged. Is a \$10,000 term policy or a \$10 million whole life policy desirable in light of the nature of the business being acquired, the manner in which it has been operated (i.e. with careful management or otherwise), and the amount of consideration being paid or received.

The second frame of reference for making the “paperwork” decision is dispute resolution. No matter how much due diligence is done by a buyer or how much scheduled disclosure is provided by a seller, post-closing disputes may well arise. “Insurance” language cannot anticipate every possible claim or disclose every risk. How will the parties deal with these matters? Basic transaction documents offer only civil suits. Lawsuits are not cost-effective methods to resolve disagreements. They should be the last resort, not the first. Clear, orderly and detailed provisions establishing purchase price escrows, bucket and basket seller protections, contractual limitations on periods in which claims may be asserted, mandatory key officer mediation, timely arbitration, etc. provide alternative means of dispute prevention and/or resolution and can lessen the buyer’s and the seller’s cost of obtaining or retaining what they bargained for. The advertising slogan “pay me now or pay me later” is not without meaning here. The legal costs of establishing orderly and prompt dispute prevention/resolution mechanisms are but a fraction of a lengthy and expensive (in both dollars and client time consumed) journey through the court system.

Our firm is committed to serving our business clients with the highest degree of professional skill. Our over 100 years of experience has taught us that fully documenting business transactions is the best and ultimately most cost-efficient method of protecting our clients’ interests. It is for our clients, however, to decide, after receiving our best counsel and advice and considering the relevant factors, how much is enough.

We would be happy to assist you in complying with any of the preceding matters. Please contact one of the following Brooks Pierce advisors if you would like to discuss these issues.

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